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In the Supreme Court of the United States

OCTOBER TERM, 1959

No. 128

A. J. OSTHEIMER, 3RD, RUTH M. OSTHEIMER,
PETITIONERS

v.

THE UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (Pet. 10-11) is reported at 160 F. Supp. 669. The opinion of the Court of Appeals (Pet. 12-19) is reported at 264 F. 2d 789.

JURISDICTION

The judgment of the Court of Appeals was entered on March 9, 1959. (Pet. 19.) A timely petition for rehearing was denied on March 31, 1959. The peti-

tion for a writ of certiorari was filed June 19, 1959. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254(1).

QUESTION PRESENTED

Whether commissions received by a life insurance agent, in the ordinary course of business, on premiums paid by him for life insurance policies which he purchased on the lives of his partners, his key employees and his children, constitute taxable income within the meaning of Section 22(a) of the Internal Revenue Code of 1939.

STATUTES AND OTHER AUTHORITIES INVOLVED

Section 22(a) of the Internal Revenue Code of 1939, Sections 29.22(a)-1, 29.22(a)-2 and 29.22(a)-3 of Treasury Regulations 111, Treasury Decision 2137, G.C.M. 10486 and Rev. Rul. 55-273 are set forth in the Appendix, *infra*, pp. 14-19.

STATEMENT

This action involves claims for refund of income taxes for the years 1947, 1948 and 1949. The facts, as found by the District Court (R. 72a-75a)[1], may be briefly summarized as follows:

During 1947, 1948 and 1949, A. J. Ostheimer, 3rd, hereinafter referred to as the taxpayer, conducted a

[1] This reference is to the findings of fact and conclusions of law proposed by the Government, defendant in the District Court. These proposed findings and conclusions were adopted by the District Court. (R. 77a.)

business as a life insurance agent. During the first seven months of 1947, the business was conducted in partnership with one Earl Zebley, and thereafter as a sole proprietorship. Among the insurance companies for which the taxpayer was licensed to act as agent in Pennsylvania were the Northwestern Mutual Life Insurance Company of Milwaukee, Wisconsin, and the Aetna Life Insurance Company. (R. 72a.)

Under his contracts with these insurance companies, the taxpayer was to receive commissions for all life insurance business he procured for the companies and which they accepted. Under the contracts, as well as by Pennsylvania statutes (40 Purdon's Pennsylvania Statutes, Annotated, Secs. 275 and 471), the companies and their agents were required to sell insurance at fixed prices without rebate of premiums or commissions. (R. 72a.)

During the taxable years, the taxpayer was the owner and beneficiary of four life insurance policies issued by Northwestern on the lives of his business partner and certain key employees. He also had procured from the same company life insurance policies for four of his children, which policies were given to such children. In addition, the taxpayer was the owner of one life insurance policy issued by Aetna on the life of his business partner. In connection with all of these policies, the taxpayer, personally and through his secretary, prepared the applications, arranged for the initial medical examinations, and remitted the premium checks to the companies. The taxpayer was designated as agent on all of the

aforementioned policies and he was entitled to receive from the insurance companies standard contractural commissions on all premiums paid. (R. 72a-73a.)

The taxpayer paid the standard premiums on all of the aforementioned policies by check drawn on his personal bank account. The policies were handled and treated by the general agents of Northwestern and Aetna in the same manner as other policies solicited by the taxpayer, and the commissions on such policies were remitted to the taxpayer in the same way as other commissions. The general agents of Northwestern and Aetna periodically submitted "Commission Statements" to the taxpayer at his place of business. These commission statements covered all amounts due him from time to time and were accompanied by checks for the total amounts then due, including, among others, the regular commissions on the policies referred to above. (R. 73a.)

Under the standard forms of agents' contracts used by Northwestern, the agent is ordinarily furnished free office space and stenographic services, or, in lieu thereof, is granted an extra commission. He is expected to work full time for the company. The company may at any time terminate the contract on thirty days' notice. The agent is considered by the company to be in a position of trust and responsibility on behalf of the company. And the agent, if he qualifies, is required to participate in the company retirement plan to which the company contributes. As a full time special agent for Northwestern, the taxpayer was obliged to give Northwestern first refusal on all life insurance business, provided it was

the kind Northwestern insured. Although in his particular case Northwestern did not provide office space and stenographic services as it did in the case of many other special agents, the taxpayer was allowed in lieu thereof an additional commission. He was covered by Northwestern's agents' retirement plan, the contributions for which were in part credited from his commissions. Since 1950, for purposes of the Social Security Act, as amended in 1950, the taxpayer has been treated by Northwestern as its employee, and it has paid social security taxes with respect to his services. The taxpayer's services and arrangement with Northwestern during the taxable years at issue were not different from what they were in 1950 and in subsequent years. (R. 73a-74a.)

In his income tax returns for the taxable years, the taxpayer did not include in his gross income any of the commissions received on these insurance policies, but he did deduct as necessary and ordinary business expenses the nominal expenses incident to such policies agreed to be in the amount of $5 per annum. (R. 74a.)

The Commissioner of Internal Revenue determined that the commissions received by the taxpayer on these policies should properly have been included in taxable income for the taxable years at issue, and accordingly he assessed deficiencies. (R. 74a.) The Commissioner's determination was sustained by the District Court upon the ground that it was in accordance with long-established administrative interpretation and upon the ground that this interpretation represented a correct view of the applicable law. (Pet. 10-11.)

The Court of Appeals unanimously affirmed. It concluded that the commissions received by the taxpayer upon the policies which he purchased constituted compensation for personal services and hence gross income within the meaning of Section 22(a) of the Internal Revenue Code of 1939. The circumstances of the transaction did not, in its opinion, establish a bargain purchase of insurance or "discount" as contended by the taxpayer.[2] (Pet. 14-15.) The Court of Appeals also concurred in the view of the District Court that the long-standing administrative interpretation, under which commissions received by a life insurance agent on policies which he purchased were held to constitute taxable income, was entitled to great weight. (Pet. 18-19.)

ARGUMENT

The issue presented here is simply whether commissions earned by a life insurance agent on insurance policies which he himself purchased constituted taxable income to the agent when received. The decisions below holding that such commissions did constitute taxable income are correct and are not in conflict with any decisions of this Court or of other courts of appeals.

1. Commissions earned on insurance premiums constitute income to the recipient within the broad

[2] In view of this holding, the Court of Appeals found it unnecessary to pass upon the Government's alternative contention that, even if the transaction be viewed as a bargain purchase, it was a benefit secured by virtue of an employment relationship and thus constituted taxable income.

provisions of Section 22(a) of the Internal Revenue Code of 1939. (Appendix, *infra*, p. 14). The provisions of Section 22(a), which have been held to reach "income derived from any source whatever" (*Commissioner* v. *Glenshaw Glass Co.*, 348 U. S. 426, 429-430), are certainly broad enough to include such commissions as income, and Section 29.22(a)-2 of Treasury Regulations 111 (Appendix, *infra*, p. 15) specifically provides that "commissions on insurance premiums" are income to the recipient. The taxpayer seeks to create an exception to this rule for commissions earned on policies of which he was the purchaser, but no such exception may be found either in the statutes or in the Regulations. Rather, the present controversy, when reduced to fundamentals, is the simple case of an employee receiving compensation for services rendered, one of the clearest types of taxable income.[3]

As both the Court of Appeals and the District Court found, the insurance companies for which the taxpayer acted as agent had a contractual obligation to pay the taxpayer commissions on all premiums received on policies which he procured. The companies did in fact pay the commissions earned and thus discharged their contractual obligation to the taxpayer. These commissions, both courts held, constituted payment for services rendered and thus gross income within the meaning of Section 22(a). (Pet. 10-11, 16.) The compensation which the taxpayer

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[3] As such, this case presents no constitutional question, notwithstanding the taxpayer's assertion to the contrary (Pet. 5).

was entitled to receive by way of commissions was measured solely by the business which he obtained for the insurance companies. Having procured purchasers of insurance policies, the taxpayer, as an agent, had fulfilled his part of the contract and was entitled to the commissions agreed upon.

No difference in result follows from the fact that in the present case the taxpayer was himself the purchaser of the insurance policies. He had procured or obtained business for the companies and was thus entitled to the agreed commissions on the premiums paid, regardless of the identity of the purchaser. Such commissions represented a "payment in return for services rendered" and thus constituted gross income. *Robertson* v. *United States*, 343 U. S. 711, 714. The position taken by the Government and adopted by the courts below is in accordance with an administrative interpretation which has been in existence for over forty years. In T. D. 2137, promulgated in 1915 (Appendix, *infra*, p. 15), the Commissioner ruled that commissions received by a life insurance agent on policies which he purchased represented income to the agent. In G.C.M. 10486 (1932) (Appendix, *infra*, pp. 15-17), this ruling was elaborated upon, and it was there pointed out that there is no distinction between commissions earned by an agent on policies purchased by others and the commissions earned on policies purchased by the agent himself. The ruling was reaffirmed once more in Rev. Rul. 55-273 (1955) (Appendix, *infra*, pp. 17-19) in which it was held that the same rule should apply, notwithstanding the fact that technically the in-

surance agent may be an independent contractor rather than a direct employee of an insurance company. Such long-standing administrative interpretations of the broad provisions of Section 22(a), left unchanged by repeated reenactments of the revenue laws, are entitled to great weight. *Lykes* v. *United States*, 343 U. S. 118, 126-127; *Mass. Mutual Life Ins. Co.* v. *United States*, 288 U. S. 269, 273.

The transaction under which the taxpayer received commissions on policies which he purchased cannot properly be viewed as resulting in a reduction in cost or a discount. The insurance companies in question were required by applicable law to sell policies at fixed or uniform rates without rebate either of premiums or commissions. (*Supra*, p. 3; Pet. 13, 16-17.) The companies could not, therefore, have legally agreed to sell policies to the taxpayer at a reduced cost, nor could they have agreed to rebate to him the amount of commissions which he would otherwise have earned. Instead, the companies did what the law required them to do, namely, to sell the policies at regular premium rates. The amounts which the taxpayer received were the commissions which the company was under a contractual obligation to pay, and as such, they represented taxable income to him.

It is true that the Tax Court has reached a contrary result on similar facts in *Minzer* v. *Commissioner*, 31 T. C. No. 115, and that in *Daehler* v. *Commissioner*, 31 T. C. No. 73, although involving different facts, the Tax Court has likewise apparently refused to adopt the contentions advanced by the

Commissioner.[4] The court below was cognizant of both of the cited Tax Court decisions (Pet. 17-18), the taxpayer having called attention to the *Minzer* case in its petition for rehearing, which the court below denied. On the other hand, the Tax Court, in deciding the *Minzer* case, did not have the advantage of the opinion on appeal here. The existence of these decisions by the Tax Court affords no basis for certiorari.

2. The decision of the courts below is not, as asserted by the taxpayer (Pet. 7), in conflict with the decision of the Court of Appeals for the Second Circuit in *Benjamin* v. *Hoey*, 139 F. 2d 945. That case involved a wholly distinguishable factual situation in which the taxpayer was a member of a partnership engaged in a stock brokerage business. The taxpayer there purchased some securities for his own account and paid the regular commissions thereon. All that the Court of Appeals held was that that portion of the commissions paid by the taxpayer which corresponded to his own partnership interest

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[4] We are not aware of the basis for petitioner's assertion (Pet. 7) that these cases were decided by votes of 10 to 6 and 10 to 5, respectively. The cases, as reported by the Tax Court, do not show the number of judges participating in the majority decision, nor is it the practice of the Tax Court to do so. See *Stern* v. *Commissioner*, 215 F. 2d 701 (C. A. 3d). In any event, the taxpayer appears to be in error as to the vote in the *Minzer* case, because the decision as reported indicates that seven different judges dissented from the majority decision, while the Tax Court has only sixteen judges in active service. Section 7443, Internal Revenue Code of 1954.

was in effect a payment to himself and did not result in the receipt of taxable income.

Unlike that case, however, the present situation does not involve a payment by the insurance agent to himself. The commissions earned upon the insurance policies do not, as the case of purchases of securities, represent an additional fee which the purchaser must pay. On the contrary, the purchaser of an insurance policy must pay the entire premium to the insurance company which then may or may not be legally obligated to pay a portion of the premium received to an agent for his services in procuring the purchase of such insurance. Likewise, this case, unlike the situation in *Benjamin* v. *Hoey*, *supra*, does not involve a payment by the agent to himself or to his own partnership, but rather a payment to a wholly independent third party. The portion of the premiums which the taxpayer, as an agent, later received as commissions proceeded from the contractual obligation of the insurance company to pay to him agreed compensation on insurance obtained by him from any purchaser, and it was a payment to the taxpayer by a totally different person—not by himself to himself. The taxpayer's attempt to assert a conflict between the decision below and that in *Benjamin* v. *Hoey*, *supra*, stems from a basic confusion between a payment received from a third party in return for services rendered, as here, and a payment made by a taxpayer to his own company or partnership for his own services. Obviously, in the latter situation, income may not be created by a taxpayer's payment to hir self for services; and it is

equally obvious that, as here, income does result from the performance of services for another for an agreed compensation. Properly analyzed, it is apparent that the decision below, both in principle and in result, is not in conflict with the decision of the Second Circuit in *Benjamin* v. *Hoey*, *supra*.

3. In any event, the decision below may also be sustained on the alternative ground that, if the transaction be viewed as a bargain purchase by the taxpayer, it was a bargain purchase arising out of an employment relationship and as such constituted taxable income to the extent of the reduction in premiums. Taxpayer cannot dispute, and in fact admits (Pet. 6), that the benefit which he received through what he asserts to be a reduction in cost arose solely from his status as an insurance agent. If that be true, then the reduction in cost was a benefit conferred upon the agent as an employee in recognition of services rendered. So considered, the amount of such benefit constitutes taxable income. *Commissioner* v. *LoBue*, 351 U. S. 243; *Commissioner* v. *Smith*, 324 U. S. 177; Treasury Regulations 111, Secs. 29.22(a)-1, 29.22(a)-3 (Appendix, *infra*, pp. 14-15). This result is not affected by the circumstances that for social security purposes, or under other technical standards, he may be regarded as an independent contractor rather than a direct employee. See *Commissioner* v. *Webster Corp.*, 240 F. 2d 164 (C. A. 2d). We are not here concerned with the tort liability of the insurance company, but with an employment relationship in the broad sense. The contracts under which the insurance companies desig-

nated the taxpayer as their agent to procure insurance, and agreed to pay him a stated compensation therefor, are forms of employment. The benefits derived from such employment, whether in the form of salary or in the form of a transfer of property at less than fair value, constitute compensation for services and are thus taxable income. *Commissioner* v. *LoBue, supra*; *Commissioner* v. *Smith, supra*.[5]

CONCLUSION

The petition for a writ of certiorari should therefore be denied.

Respectfully submitted,

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JULY, 1959.

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[5] In view of the authorities cited, the brief filed by the *amicus curiae* is in error when it states (p. 5) that benefits derived from bargain purchases by specified groups of employees do not constitute taxable income. Moreover, such bargain purchases are expressly included in gross income by the provisions of Section 29.22(a)-1 of Treasury Regulations 111.

APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * *

(26 U. S. C. 1952 ed., Sec. 22.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.22(a)-1 [As amended by T.D. 5507, 1946-1 Cum. Bull. 18]. *What Included in Gross Income.*— * * *

* * * *

If property is transferred by an employer to an employee for an amount less than its fair market value, regardless of whether the transfer is in the form of a sale or exchange, the difference between the amount paid for the property and the amount of its fair market value is in the nature of compensation and shall be included in the gross income of the employee. In computing the gain or loss from the subsequent sale

of such property its basis shall be the amount paid for the property, increased by the amount of such difference included in gross income.

* * * *

Sec. 29.22(a)-2. *Compensation for Personal Services.*—Commissions paid salesmen, compensation for services on the basis of a percentage of profits, commissions on insurance premiums * * * are income to the recipients * * *.

* * * *

Sec. 29.22(a)-3. *Compensation Paid Other Than in Cash.*—If services are paid for with something other than money, the fair market value of the thing taken in payment is the amount to be included as income. If the services were rendered at a stipulated price, in the absence of evidence to the contrary such price will be presumed to be the fair value of the compensation received. * * *

T. D. 2137, 17 Treasury Decisions 48 (1915):

Part I.—*Rulings in relation to personal income tax.*

* * * *

Commission retained by agent on his own life insurance policy.—A commission retained by a life insurance agent on his own life insurance policy is held to be income accruing to the agent, and should be included in his return of income for the assessment of the income tax.

* * * *

G.C.M. 10486, XI-1 Cum. Bull. 14 (1932):

Information is requested relative to the basis on which a ruling relating to insurance commissions was made.

The particular ruling, which is one of several rulings contained in Treasury Decision 2137, reads as follows:

> *Commission retained by agent on his own life insurance policy.*—A commission retained by a life insurance agent on his own life insurance policy is held to be income accruing to the agent, and should be included in his return of income for the assessment of the income tax.

If a life insurance company reduces the standard charge of an insurance policy to a purchaser and the relationship of employer and employee does not exist, the amount by which the policy is reduced can not be considered income at the time of purchase for the reason that it is not "gain derived from capital, from labor, or from both combined," nor "profit gained through a sale or conversion of capital assets" within the meaning of the definition of income as stated in *Eisner* v. *Macomber* (252 U. S. 189, T.D. 3010, C.B. 3, 25). The Board of Tax Appeals has held that the purchase of property at a bargain price does not result in taxable income where the sale is consummated by two persons dealing at arms' length. (See Appeal of *Manomet Cranberry Co.*, 1 B.T.A. 706, C.B. IV-1, 3.)

The reason that the commission allowed an insurance agent on a policy taken out on his own life is considered income, is that the relationship of employer and employee exists between the insurance company and the agent, and inasmuch as the insurance company is under contract to pay the agent commissions on all policies of insurance secured by him, no dis-

tinction can logically be made between a commission paid to the agent on account of a policy written on his own life and a commission paid to the agent on account of a policy written on the life of some one else. The commission is paid to the agent as compensation for services rendered as an employee, i.e., on account of business obtained, regardless of whose life is insured, and is "gain derived from labor," and therefore taxable income. Furthermore, it is immaterial whether the agent remits to the company the standard charge for such insurance (namely, the amount that would be charged any other person under like conditions) and receives a check for his commission, or whether he remits to the company the standard charge minus his commission. The net result is the same. The agent receives taxable income to the extent of the commission, either actually or constructively. It follows that the amount of commission paid by the insurance company should be reported as income by the insurance agent.

Rev. Rul. 55-273, 1955-1 Cum. Bull. 221:

Advice has been requested whether the commission retained by an insurance salesman on an insurance policy which he purchased on his life and property under the following circumstances constitutes income to him subject to withholding of Federal income taxes.

In the instant case, an insurance salesman, as an employee of a general insurance agency who is entitled to commissions on policies which he sells, purchased policies for his own protection on his life and property through the agency for which he works at the price charged by the

agency for such insurance, less the salesman's commission.

Section 22(a) of the Internal Revenue Code of 1939, provides in part as follows:

> "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *.

G.C.M. 10486, C.B. XI-1, 14 (1932), holds that a commission retained by an agent on his own life insurance policy is income accruing to the agent due to the fact that an employer and employee relationship existed between the agent and the insurance company and the company was under contract to pay the agent commissions on all policies secured by him.

The principles of G.C.M. 10486, *supra*, are equally applicable to the facts in the instant case. There is no real distinction merely by reason of the fact that here the salesman was an employee of an insurance agency rather than a direct employee of an insurance company.

The agency was authorized to issue insurance contracts for insurance companies, employed its own salesmen and paid them a commission on each policy they secured. An employer and employee relationship existed between the insurance agency and its salesmen and the salesmen were entitled to a commission as compensation for policies sold by them irrespective of whether such commission was received in cash or in the form of reduced costs on policies taken through the agency.

Also, there may be insurance salesmen who might be considered independent contractors. These salesmen, like other insurance salesmen, are also entitled to a commission on each policy

secured by them as compensation for their services irrespective of the manner in which received.

Accordingly, it is held that the commission retained by an insurance salesman in the form of reduced costs on an insurance policy on his life and property, which he purchased from an insurance agency or company, constitutes income to the salesman regardless of whether the salesman is an employee or independent contractor. The amount of such retained commission is subject to withholding of Federal income taxes.

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